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ON THE ROUTE TO RECOVERY

A conversation with ...

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A New Lease on Life

Some airlines turn to leasing options when upgrading their fleet, while others purchase aircraft outright hoping to increase the value of their airline.

■ By Stephani Hawkins | *Ascend* Editor

As airlines around the world take hold of the industry's upturn and continue refining their operations to become more closely aligned with the changed landscape, conserving cash remains a critical part of their revival.

Keeping their dollars close to the vest, 46 percent of the world's top 500 airlines lease all or portions of their fleet (a 10 percent increase from five years ago) rather than laying

down large sums of money to purchase aircraft.

"If I was starting an airline, instead of investing my equity in buying an asset that is going to reduce in value, I would rather keep a hold of my capital and lease the aircraft," said Nejib Ben-Khedher, senior vice president of Sabre Airline Solutions Consulting. "Then you have the capital in the bank to use for other investments that are going to retain their value, like real estate."

There is much debate surrounding the pros and cons of each option, and some industry experts believe that in the long term, some form of leasing will prevail and traditional purchasing will become a thing of the past.

"The way the industry is going, most airlines are simply not going to own their equipment," Ben-Khedher said. "They are either going to lease it purely from a third-party provider and pay only for utilization, or they are going to set up 'special purpose vehicles' — a 'lease-to-own' option — which protect the asset in the event the carrier goes bankrupt. I think the period of owning the equipment outright, for many airlines, is over."

On the other hand, there's the argument that owning aircraft sustains the capital value of an airline. At least that was true a few years back when specific aircraft types were in high demand and appreciated with time. Airlines knew they could buy an aircraft and two years later it would be worth more than they paid for it.

In the "old" days, growth in the industry was so high that airplane manufacturers couldn't keep up with demand. But today, as the leading creators of aircraft compete with each other, numerous different aircraft types have come into existence, saturating the market with an overabundance of "tin" and driving the value of aircraft downward.

"When you have an asset that is intrinsically going to reduce its value year after year ... do you buy it and know that every year the value of your asset decreases?" Ben-Khedher said. "Or do you lease it? Leasing is about paying for utilization of the aircraft instead of paying the full price of the aircraft."

Weighing the Options

Leasing didn't just catch on as a way to offset the aftermath of a wounded industry. During the past several years, and perhaps the last couple of decades, it has become a growing

Image courtesy Pakistan International Airlines



Pakistan International Airlines is one of the carriers leading the way in obtaining aircraft through special purpose vehicle lease financing options, which enable the airline to take ownership of aircraft at the end of the lease term. Last year, the airline obtained more than 10 aircraft under special purpose vehicle-based lease financing agreements.



Sabre Airline Solutions

trend. And what fuels it is a host of factors that appeal to airlines striving to refresh their fleet without the capital expenditures that accompany ownership.

One advantage of leasing an aircraft, similar to leasing an automobile, is that “when you’re done, you can turn in the keys,” said Eric Jones, manager, communications for the aircraft leasing business of General Electric. “You want a bigger or more modern airplane, you can turn it back in. The great thing about that is it isn’t your problem. It is our problem. We own it. We have the residual value risk in our hands as opposed to you. You can move on and do what you do best, which is running an airline.”

According to Jones, the greatest advantage of leasing, possibly above the financial benefits, is flexibility.

three represent popular choices among many carriers worldwide, and two of those enable carriers to retain the asset in the end.

Operating Lease: No Money Down

A clear advantage of the operating lease is that at the end of the leasing term, the airline returns the aircraft to the lessor without further obligation. Through this conventional method, the airline determines the dates in which it would like to lease the aircraft, and both companies agree on certain aspects of the contract such as which company will assume responsibility for maintenance.

“Maybe the lessor has some maintenance responsibilities, and you have some maintenance responsibilities,” said Ben-Khedher. “You pay a fixed amount per month to lease the aircraft. At the end of the period of time, it goes back to them and you have no rights to it.”

Through this approach, the leasing company estimates what the value of the aircraft will be at the end of the lease and applies a profit margin to determine the monthly payment, which is likely to be higher than it would be if purchasing the aircraft through traditional financing. However, if the airline is not in a position to make a sizable down payment or does not qualify for certain types of credit, it may be more logical to pay the higher monthly rate to obtain the aircraft.

Selecting the operating lease, the airline is essentially paying for the “utilization of the equipment ... and a portion of the ‘heavy check’ that aircraft is going to have to undergo later on,” said Ben-Khedher.

Another appealing aspect for many carriers is the ability to frequently upgrade their fleet.



As airlines of all sizes around the world look to upgrade or grow their fleets, more of them are leasing as a more cost-effective means of acquiring aircraft rather than purchasing them outright.

“If you want to be known as the world’s youngest equipment airline, you lease the equipment,” Ben-Khedher said. “After five or seven years, you just ‘flip’ that piece of equipment for a newer piece.”

Finance Lease: Capital Outlay

While the “finance” or “capital” lease requires a down payment, the airline not only shows a portion of the airplane as an asset on its books during the leasing period, it may save on taxes

“... the greatest advantage of leasing, possibly above the financial benefits, is flexibility.”

“When you lease it, you may pay a little higher monthly charge, but you get flexibility,” he said. “For example, if there is a downturn or traffic curtails, you only have it for two more years. Maybe you don’t need that extra airplane. You can get rid of it — turn it back in and walk away.”

If leasing really is the better option for the current environment, maybe the more appropriate question is: What type of lease is most fitting for an individual airline? Today, there are a number of possibilities that can be exercised depending on an airline’s financial situation, credit status and specific needs. But

THE HIGH • LEVEL view

News Briefs from Around the Globe

Who

China Eastern Airlines

What

Selected the *Sabre® AirFlite™* Schedule Manager to manage its flight schedules and improve its profitability across all regional, short-haul and long-haul routes.

Why

“In our drive to be a major player in the Asian region, this solution will go a long way to boosting our efficiency, tighten our accuracy and provide more decision support in an increasingly competitive market,” said Hu, Zhen Ming, standing deputy director

of marketing and sales for China Eastern. “Overall, we expect to see our top-line revenues increase by between 1 percent and 3 percent. In today’s challenging environment, we must focus on proven solutions that deliver the desired result.” [E](#)

if it is investing income that would otherwise be recorded as profit. And in the end, it still has the option of returning the aircraft to the leasing company. However, if the contractual residual value of the aircraft is less than what the aircraft is actually worth at the end of the term, the airline has an opportunity to purchase the aircraft for the contractual residual. It can then sell the aircraft for a profit, or it can continue to operate the aircraft. Either way, the value of the airline has been increased.

Under this agreement, a key advantage for the airline is that in addition to taking partial ownership of the aircraft, the risks associated with aircraft devaluation are of no consequence.

"The great thing about the finance lease from the airline's point of view, they own a portion of it, so it improves the value of the company," Ben-Khedher said. "They do not have to own the unit outright. They do not have to take the risks of its value going down very heavily."

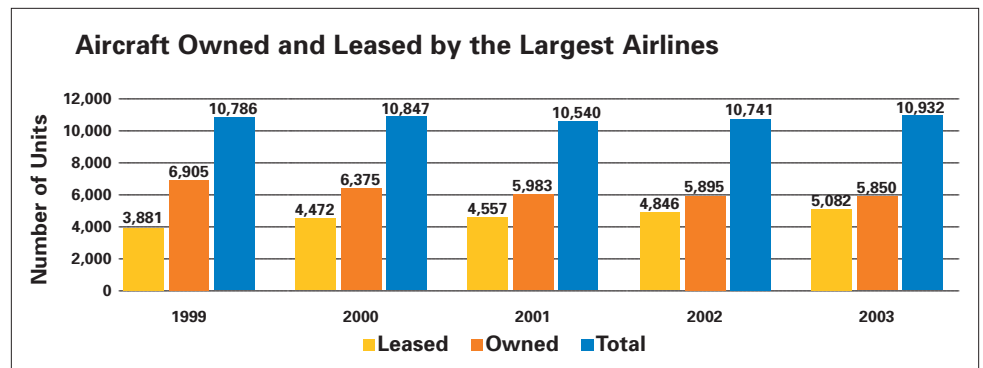
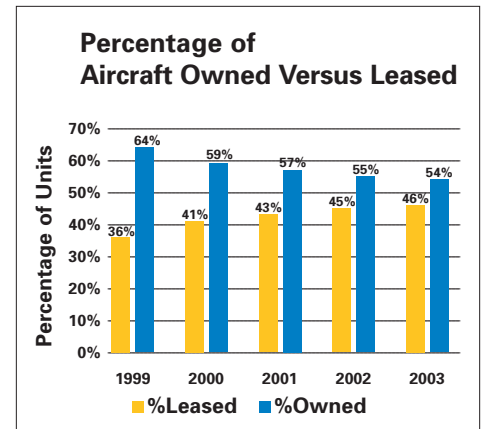
The Best of Both Worlds

What has become an ideal option for many airlines is the ability to acquire aircraft with the same safety guarantees that traditional leasing offers, yet own the aircraft at the end of the agreement. A growing trend among government-owned carriers, and a viable choice for privately owned carriers as well, is special purpose vehicle-based lease financing where, in some instances, a new company is created specifically to lease aircraft to a particular airline that will eventually own the asset.

"Government-owned carriers want to see the assets on the books," Ben-Khedher said. "That way the company has a value. Governments were always leery of using leases because their citizens would say that it's just a 'paper' airline. They do not own anything. So what was developed several

years ago is something known as a special purpose vehicle."

What makes this option so popular for government-owned airlines is that in some instances, the special purpose vehicle company is developed and owned by the government; therefore, if the airline fails, the government still has possession of the asset. If it is not owned by the government, the SPV-based company has reduced risk because it holds the title to the asset until it's paid in full, enabling it to sell or lease the aircraft to another company if the original lessee defaults.



The past four years have reflected a growing trend of airlines leasing a larger percentage of their fleets. While the total number of aircraft flown has remained largely stable, a greater percentage of the world's aircraft are now leased, enabling many airlines to cost-effectively upgrade their fleets with more modern, fuel-efficient aircraft. By 2003, almost half of the aircraft flown by the largest airlines were leased rather than owned.

Typically, the SPV-based company is established in another country, and its government receives "hard" cash for the SPV arrangement. In turn, the airline does not have to pay corporate taxes for the SPV, and it receives import/export credits from the country in which the SPV exists.

Alternatively, airlines that qualify can set up SPV-based lease financing through interna-

tional export banks and similar lending institutions. In 1991, Pakistan International Airlines entered into its first SPV-based lease, acquiring six A310 aircraft under the guarantee of European export credit agencies.

"SPV is a conduit to raise money for financing aircraft," said Ahmed Saeed, chairman and chief executive officer of PIA. "Airlines normally do not have large surplus

THE HIGH • LEVEL view

News Briefs from Around the Globe

Who

TransMeridian Airlines

What

Agreed to have its fares distributed through the *Sabre*[®] global distribution system.

Why

"We firmly believe that being in the global distribution system will make our airline even more attractive to the travel agent community," said Rob Binns, president of TransMeridian

Airlines. "We are confident that *Sabre Connected*sm travel agents will take advantage of this opportunity and offer our everyday low fares to their customers." [e](#)



funds to deploy in outright purchase of aircraft because huge investment is required. The SPV raises the funds from the market to purchase the aircraft and leases it to us. We pay monthly rental installments to the SPV. The title to the aircraft remains with the SPV until the total loan installments are paid. At which time we take ownership of the aircraft, and they become assets."

Two years ago, the airline took the same approach using the Export-Import Bank of the United States, the U.S. government's official export credit agency, which guarantees term financing on soft terms to creditworthy international buyers in private and public sectors by covering 100 percent of the associated commercial and political risks.

"We've had ongoing discussions with the leadership of both Pakistan International Airlines and the Ministry of Finance about how best to structure a possible sale of U.S.-manufactured aircraft to PIA," said James Lambright, executive vice president of Ex-Im Bank during a 2002 speech to the International Chamber of Commerce in Karachi, Pakistan. "When this transaction is concluded, it will upgrade the quality of PIA's fleet; and as busi-

nesspeople, you understand the benefits of improved flying conditions and improved prospects for the airline's finances."

Through international financing institutions, last year PIA purchased more than 10 aircraft under SPV-based agreements.

"U.S. Ex-Im Bank is a relatively cheaper source of financing," said Saeed. "This financing structure requires creation of an off-shore company (SPV), which leases aircraft to PIA."

Through Ex-Im Bank-supported funding, the airline introduced three Boeing 777-200ERs into its fleet earlier this year using SPV-based lease financing. Five more aircraft in the Boeing 777 family will be purchased through this financing structure — two in 2006 and three in 2008.

"We look forward to providing support for PIA's purchase of other U.S.-manufactured aircraft and engines in the future," said Ex-Im Bank President and Chairman Philip Merrill.

The only disadvantage of leasing through a special purpose vehicle rather than purchasing aircraft outright through traditional financing is that "the title to the aircraft remains with the SPV," Saeed said. "The title reverts to the lessee when the financing is fully repaid."

The Bottom Line

A variety of choices for acquiring aircraft leave many of the world's airlines in a favorable position to upgrade their fleet using methods that will positively impact their bottom line.

For government-owned airlines that place a strong emphasis on showing assets on the balance sheet, the SPV option likely outweighs the others. Privately owned airlines that are seeking to obtain new aircraft and are not faced with disqualifiers, such as credit issues, may lean toward SPV-based lease financing as well for the many benefits it offers.

Every airline has its own unique set of circumstances. As with the aviation industry, aircraft leasing companies and financial institutions have entered a new era with new surroundings. Taking into account the number of viable purchasing and leasing options available today, most airlines, regardless of their distinctive conditions or geographic location, are well positioned to attain a younger fleet and grow their operation during the industry's upswing. **E**

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hightech

News on New and Improved Products and Services from Sabre Airline Solutions

product

Customer Insight

description

Customer Insight, formerly the *Customer Profile System*, is a comprehensive relational database that collects and stores information on a traveler. Through the use of *Customer Insight*, an airline will have a simplified method of looking at and relating data about its customers.

benefits

Customer Insight provides a central location to store relevant customer information. Making this information available to airline agents at all customer touch points enables them to recognize each traveler

and provide personalized service to customers.

features

- **Flexible access** — Agents are provided real-time access to display, create or modify customer information via *SabreSonic™* Res or Web services. The Web service interface enables access from a wide variety of applications or devices.
- **Comprehensive data** — Expanded customer data can be stored including:
 - Personal information — Name, address, phone, e-mail address, document information,
 - Preferences and policies — Special service requests and other service information, preferred services,
 - Airline relationship information —

Frequent traveler information, club information, value score, customer comments,

- Marketing information — Annual trip count, average trip length,
- Corporate information — Company name, job title, number of employees.
- **Single view** — Agents are provided a single view of the traveler throughout the travel experience. When accessed through Web services, connectivity to customer touch-point applications and devices is minimized.
- **Increased productivity** — *Customer Insight* improves the accuracy and efficiency of passenger name record creation through the use of structured data creation, enabling agents to focus on customer interaction. **E**